IN THE

Supreme Court of the United States

October Term, A.D. 1942.

No. 512

STANDARD OIL COMPANY (INDIANA), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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LIST OF AUTHORITIES CITED.

MISCELLANEOUS.

REVENUE ACTS.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States.

The petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above cause on June 12, 1942.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 319-361) is reported in 43 B. T. A. 973. The opinion of the Circuit Court of Appeals (R. 391-408) is reported in 129 F. (2d) 363.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered June 12, 1942. (R. 408). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

During the year 1930 petitioner's affiliate, the Stanolind Crude Oil Purchasing Company (known as the Sinclair Crude Oil Purchasing Company prior to September 22, 1930, and hereinafter referred to as "Stanolind") paid to the United States of America the sum of $2,906,484.32 including interest of $908,893.06. Said amount represented a judgment entered in a trover action against Stanolind in favor of the United States during said year. Stanolind, by virtue of the said payment acquired a cause of action against another corporation and was able to collect $4,618.86 on the said cause of action. The balance of said payment, $2,901,865.46, was not recoverable from any source and therefore represented a complete loss in the sense of a diminution of assets.

The question presented herein is whether or not the said balance of $2,901,865.46, or any part thereof, may be deducted in computing the consolidated net income of petitioner and affiliates for said year.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statutory provisions and regulations herein involved are contained in the Appendix.

SUMMARY STATEMENT OF THE MATTER HEREIN INVOLVED.

Stanolind was incorporated on February 5, 1921. (R. 129, 326.) Its sole stockholders from date of incorporation to September 22, 1930 were the Sinclair Consolidated Oil Company, hereinafter sometimes referred to as "Sinclair" and

petitioner, each of which owned 50 per cent of the stock, and each of which, pursuant to an agreement between them, named one-half of the Board of Directors of Stanolind. (R. 129, 326). On September 22, 1930 petitioner purchased the one-half interest belonging to Sinclair and thereupon became the sole owner thereof. (R. 129, 326).

The Mammoth Oil Company (sometimes hereinafter referred to as "Mammoth") was incorporated on February 28, 1922.

On October 24, 1922, Stanolind entered into a contract with the Midwest Refining Company (another subsidiary of petitioner, and hereinafter sometimes referred to as "Midwest") and Mammoth, whereby each of the two latter companies agreed to sell to Stanolind at prevailing posted prices Wyoming crude oil "to an amount not exceeding thirty million barrels". (R. 130, 327-330.) Each of the sellers also guaranteed title and agreed to hold Stanolind harmless.

This contract was performed by the parties until March 12, 1924 when receivers were appointed for Mammoth in an equity suit brought in the United States District Court for the District of Wyoming, hereinafter for convenience sometimes referred to as the "Wyoming suit" or "Wyoming case". Up to that time Mammoth had sold Stanolind 1,430,024.70 barrels of crude oil for which Stanolind paid Mammoth an aggregate of $2,167,591.26. (R. 130.)

In its returns for the years prior to 1928, Stanolind duly reported all of the income realized by it from the sale of the said crude oil and no part thereof has ever been eliminated from its taxable income. (R. 130-131.)

In December, 1928, the United States brought an action of "trespass on the case in trover" against Stanolind in the United States District Court for the District of Delaware, hereinafter sometimes referred to as the Delaware case or suit, for the conversion of the said 1,430,024.70 barrels of crude oil. (R. 133-134, 226-236, 336-339).

The declaration filed in said Delaware suit contained three counts. The first count claimed, exclusive of interest, the value of the oil as of the alleged dates of conversion (substantially the same as the amount which Stanolind had paid Mammoth). (R. 227, 330, 338.) The second and third counts claimed, exclusive of interest, not only the value of the oil as of the dates of the alleged conversion, but also exemplary and punitive damages on the grounds that Stanolind had acquired the oil with full knowledge of Mammoth's fraud in obtaining it, and had with said knowledge, "wrongfully, willfully, unlawfully and fraudulently converted and manufactured the said crude oil into fuel oil and other refined petroleum products and thereby increased the value thereof by the sum of $1,000,000". (R. 230, 338.)

In the latter part of 1929, Stanolind (after answer, replication and demurrer had been filed) offered to terminate the Delaware suit by paying to the United States the sum of $2,167,591.26, the value of the oil as represented by the prices which Stanolind had paid Mammoth as aforesaid, less the sum of $170,000, the estimated value of seventeen oil storage tanks on the Teapot Dome lease belonging to Stanolind, with interest computed on both at the rate of 7 per cent per annum (the legal rate in Wyoming). (R. 134, 251, 252, 339, 341). Counsel for the United States in said action, the Honorable Owen J. Roberts and the Honorable Atlee Pomerene, recommended the acceptance of the proposed offer in a letter to Senator Thomas J. Walsh dated April 3, 1930. The following statements are quoted from the said letter: (R. 251, 253, 340, 341, 342.)

> "* * * This suit was for the conversion of the oil by the Sinclair Crude Oil Purchasing Co. based upon the theory that as the Mammoth Oil Co. had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.
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> * * * * * * * * * *
>
> "* * * As the proposition was substantially for the full amount which the Government could recover, it

was thought wise to accept it and close the litigation. * * *

* * * * * * * * * *

"The Sinclair Crude Oil Purchasing Co. we think properly takes the position that we as special counsel have no authority to settle this case or to satisfy any judgment which may be taken by agreement in the case without a resolution of Congress authorizing us so to do. * * *

* * * * * * * * * *

"As we have heretofore advised, we consider this a very advantageous settlement to the Government. * * *

* * * * * * * * * *

"Under the proposed arrangement the Government is, we think, getting as favorable a result as it could get by pursuing the litigation to judgment and execution."

On April 14, 1930 the Committee on Public Lands and Surveys of the United States Senate recommended the passage of a joint resolution authorizing the said settlement on the aforesaid basis, (R. 134, 251, 343) and Congress approved the agreement by a joint resolution. (R. 135, 343.)

On May 28, 1930 the parties filed a stipulation in the Delaware case which included the following: (R. 135, 255, 344)

"* * * *that the fair amount due to the plaintiff in the above entitled action is the sum of $2,906,484.32* * * *".

Pursuant to said stipulation, judgment for $2,906,484.32 was entered on May 28, 1930 and paid on June 2, 1930. (R. 135, 344.) *Said judgment represented principal in the amount of $1,997,591.26, and interest in the amount of $908,893.06.* (R. 134, 135, 249, 340.) At the time of said judgment, Stanolind owed Mammoth $4,618.86. Except for said liability, Stanolind's claim against Mammoth, which arose by reason of said payment to the United States, was worthless and unrecoverable. (R. 135, 330, 345.) The balance of said claim in the amount of $2,901,865.46 was charged off on Stanolind's books.

In its separate return for the period January 1 to September 21, 1930 Stanolind reported a net loss which included a deduction for said amount of $2,901,865.46. (R. 345.)

In the return filed by petitioner for itself and affiliates (including Stanolind) for the year 1930, said net loss was taken as a deduction in computing the consolidated net income of the said group. (R. 345.)

In a deficiency notice to petitioner for the calendar year 1930, the Commissioner disallowed the said deduction of $2,901,865.46 on the ground that it was a voluntary payment. (R. 29, 352.) Said disallowance was sustained by the Board of Tax Appeals on the ground of "public policy". (R. 354-361.)

On appeal to the United States Circuit Court of Appeals for the Seventh Circuit, the said Court affirmed the Board and held that the asserted deduction was barred on grounds of public policy. (R. 391-408.) The said Circuit Court of Appeals also rejected petitioner's claim for increased depreciation covering certain patents, which issue is not pressed in this petition.

SPECIFICATION OF ERRORS TO BE URGED.[1]

1. The Circuit Court of Appeals erred in affirming the order of the Board of Tax Appeals, and in failing and refusing to hold that the amount of the payment, or any part thereof, which Stanolind made to the United States during the year 1930, as aforesaid, be allowed as a deduction, in computing Stanolind's net loss, and in turn, the consolidated taxable net income of the group for the said year.

2. The Circuit Court of Appeals erred in disallowing the deduction of said payment either as a bad debt, an ordinary and necessary business expense, or as a loss.

3. The Circuit Court of Appeals erred in holding that the deduction sought was precluded on grounds of public policy.

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[1] The Court's attention is particularly invited in this connection to the petition for rehearing of the lower court's decision. (R. 410-418.)

4. The Circuit Court of Appeals erred in disallowing that portion of the said payment representing the payment of interest.

5. The Circuit Court of Appeals erred in accepting a so-called "finding of fact" by the Board of Tax Appeals that Stanolind acted in bad faith and as a *mala fide* trespasser upon Government lands in acquiring the oil in question, said "finding" having been based solely upon a conclusion of law that the Wyoming decree was *res judicata* in this case.

6. The Circuit Court of Appeals erred in holding, in effect, that the Wyoming suit was *res judicata* of this case and in failing and refusing to hold the Delaware judgment to be solely *res judicata.*

7. The Circuit Court of Appeals erred in failing to adopt the same interpretation of the record, *including this Court's opinion,* in the Wyoming case as that adopted by the Congress and counsel for the United States in the settlement of the Delaware case.

8. The Circuit Court of Appeals erred in deciding the question herein presented on the basis of assumed facts not of record.

9. The Circuit Court of Appeals erred in holding Stanolind to be in *pari delicto* with Mammoth in an alleged illegal transaction.

10. The Circuit Court of Appeals erred in holding that the said payment made by Stanolind constituted damages arising from a fraudulent transaction allegedly perpetrated upon the United States.

11. The Circuit Court of Appeals erred in holding that a judgment for damages arising out of a tort against the United States is, for tax purposes, distinguishable from cases where the damages arise out of a tort against a private citizen.

REASONS FOR ALLOWANCE OF WRIT.

1. The question involved is one of general importance.

The Court below recognized the unique and unusual character of the issue involved. (R. 401.) The decision, therefore, as a precursor excites a query of gravity and general importance in the administration of the Federal revenue laws which should be reviewed by this Court. In its broader aspects, the question here concerns the power of administrative officials to make sweeping denials of tax deductions expressly granted by the Statute on the ground alone that they are "against public policy".

This case involves the deductibility of an amount representing a payment made to the United States in satisfaction of a judgment entered in a trover action. A substantial portion of said payment represented interest.

The applicable revenue act allows deductions from gross income of (1) losses sustained during the taxable year; (2) ordinary and necessary expenses paid or incurred during the taxable year; (3) debts ascertained to be worthless and charged off within the taxable year; and (4) interest paid or accrued within the taxable year on indebtedness. (See Appendix.)

The regulations promulgated under the applicable Revenue Act allowed as a deduction: (Art. 342 of Reg. 74) "judgments or other binding adjudications * * *". (See Appendix.) This regulation was applied by the Commissioner in similar situations in *S. M. 4078*, C. B. V-1, p. 226 (1926); *I. T. 1853*, C. B. II-2, p. 124 (1923); and by the Courts and the United States Board of Tax Appeals[1] in *Helvering* v. *Hampton* (C. C. A. 9), 79 F. (2d) 358; *International Shoe Co.*, 38 B. T. A. 81; *W. R. Hervey*, 25 B. T. A. 1282; *Charles R. Stuart*, 38 B. T. A. 1147; *North American Investment Co.*, 24 B. T. A. 419, and *Shiman* v. *Commissioner* (C. C. A. 2), 60 F. (2d) 65.

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[1] Now called "The Tax Court of the United States," Sec. 504, Revenue Act of 1942.

This Court has applied the doctrine of public policy in tax cases in only one instance, *Textile Mills Securities Corp.* v. *Commissioner,* 314 U. S. 326. That case involved a deduction claimed for lobbying expenses. The regulations had since 1915 expressly disallowed such deductions, and this Court simply approved the Regulations.

Examination of the so-called public policy cases decided by other Federal Courts and the Board of Tax Appeals (other than the lobbying expense cases) reveals that they involved, (1) fines or penalties incurred as a result of statutory violations; (2) legal expenses in defending criminal prosecutions, or (3) commercial bribery or similar offenses. *Great Northern R. Co.* v. *Commr.,* 40 F. (2d) 372, 373, cert. den. 282 U. S. 855; *Burroughs Bldg. Material Co.* v. *Commr.,* 47 F. (2d) 178, 179, 180; *Helvering* v. *Hampton* (C. C. A. 9), 79 F. (2d) 358, 359, 360; *Chicago, R. I. and P. Ry. Co.* v. *Commr.,* 47 F. (2d) 990, 991; *Tunnel R. R. of St. Louis* v. *Commr.* (C. C. A. 8), 61 F. (2d) 166, 173; *W. R. Hervey,* 25 B. T. A. 1282, 1290, 1291; *S. M. 4078* (1926), C. B. V-1, p. 226; *Easton Tractor & Equipment Co.,* 35 B. T. A. 189; *T. G. Nicholson,* 38 B. T. A. 190; *Frank A. Maddas,* 40 B. T. A. 572.

In all of the above cases, the doctrine of public policy was used as an aid in interpreting the statute and not as justification for refusing to apply the Statute and regulations. In this case the Court disallowed a deduction for a judgment in an ordinary tort action—in spite of the fact that it falls within the express language of the Statute and regulations.

It is submitted that the attempt of the Commissioner to apply the doctrine of public policy in this case contrary to the regulations and to read into the Statute a provision which is not there, is beyond his power, and the approval of the Commissioner's action by the Board and the Circuit Court of Appeals should be reviewed by this Court.

The scope of the doctrine of public policy and the extent to which it can be applied in tax cases should be clearly de-

fined. It should not be left to the discretion of the Commissioner of Internal Revenue to determine whether, and to what extent, if any, he can ignore the express provisions of the Statute on the grounds of public policy.

2. As applied to the stipulated facts in this case, as distinguished from the facts erroneously assumed by the court, the judgment of the court below clearly involves a new and unique question which should be considered by this court.

The expenditure herein involved constituted the payment of the judgment in the Delaware suit, a Court action involving no criminal aspects whatsoever. *That suit was for the conversion of the oil by Stanolind based upon the theory that as Mammoth had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.* Stanolind was in the business of buying and selling oil, and the oil in question represented less than 3 per cent of Stanolind's total purchases of oil for the period in question.

In the first count, the United States claimed merely the value of the oil as of the dates of the alleged conversion. In the second and third counts, it claimed "exemplary" or "punitive" damages in the amount of $1,000,000. Such damages may only be recovered where the conversion is willful or intentional. *Scott* v. *Donald*, 165 U. S. 58; *United States* v. *Ute Coal & Coke Co.* (C. C. A. 8), 158 F. 20; *Trustees Dartmouth College* v. *International Paper Co.*, 132 F. 92; *Armstrong* v. *Rhoades*, 20 Del. 151, 53 A. 435; *Hendle* v. *Geiler* (Del.), 50 A. 632; *Hall Oil Co.* v. *Barquin*, 33 Wyo. 92, 237 P. 255.

The Delaware case was settled by the acceptance of Stanolind's offer to pay for *the value of the oil, the amount claimed in the first count, less a credit for the value of Stan-*

olind's tanks on the Mammoth lease. Both the Congress (which approved the settlement)[1] and counsel for the United States, who had represented the Government in both the Wyoming and Delaware cases, emphasized the fact that the proposition was substantially for the full amount which the Government could have recovered had it pursued "the litigation to judgment and execution". (R. 253, 342.)

The claims for "exemplary" or "punitive" damages demanded in the second and third counts of the plaintiff's declaration in the Delaware suit, were abandoned by the United States. They could have been sustained if bad faith or *mala fides* in the purchase of the oil had already been adjudicated as claimed by the Board and the Circuit Court. *Day* v. *Woodworth et al.*, 54 U. S. 363, 371, 14 L. ed. 181, 185; *Scott* v. *Donald*, 165 U. S. 58, 88, 41 L. ed. 632, 637; *United States* v. *Ute Coal & Coke Co.* (C. C. A. 8), 158 F. 20, 23; *Armstrong* v. *Rhoades*, 20 Del. 151, 53 A. 435; *Hendle* v. *Geiler* (Del.), 50 A. 632, 633.

The absence of any fraud or bad faith on the part of Stanolind was further established by the express allowance for the storage tanks. An improver who has not acted in good faith cannot recover for his improvements. Such recovery is denied on the ground of public policy. Woodward, *"The Law of Quasi Contracts"* (1913), Sec. 135; *Casper Nat. Bank* v. *Swenson et al.*, 42 Wyo. 113, 291 P. 812, 817; *Kentucky River Coal Corp.* v. *Combs*, 269 Ky. 365, 107 S. W. (2d) 241, 245.

Counsel for the United States in their letter to Congress, in the full observance of their public trust, recognized that exemplary or punitive damages could not be recovered, further that Stanolind was affirmatively entitled to the value of the storage tanks.

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[1] This approval of the settlement by Congress in the light of the existing statute allowing deductions on account of payments in satisfaction of judgments in tort actions, coupled with the Commissioner's rulings and regulations, fixed the public policy of this case. The approval was without reservation that the amount paid would not be deductible for tax purposes.

The judgment by stipulation (in trover) in the Delaware case, therefore, represented a definite determination of issues between the parties—(1) that Stanolind was liable for the value of the oil and the United States was entitled to no more, and (2) that Stanolind was entitled to reimbursement (by way of an equitable offset at least) for the amount by which the United States had been unjustly enriched by the retention of Stanolind's tanks, a clear recognition that they had been acquired and erected by Stanolind in good faith. The judgment was not a compromise in the ordinary sense of a lump sum settlement to avoid further litigation. It was meticulously computed upon the basis of the issues conceded, and the definite liabilities fixed, by the agreement of the parties.

The judgment was, therefore, *res judicata* of, and conclusively determines, the character of the payment herein involved for tax purposes. *United States* v. *Parker,* 120 U. S. 89, 30 L. ed. 601, 604; *Bullard* v. *Commr.* (C. C. A. 7), 90 F. (2d) 144, 147; *O'Cedar Corporation* v. *F. W. Woolworth Co.* (C. C. A. 7), 66 F. (2d) 363, 366; *Pick Mfg. Co.* v. *General Motors Corporation* (C. C. A. 7), 80 F. (2d) 639, 641; *Rector* v. *Suncrest Lumber Co.* (C. C. A. 4), 52 F. (2d) 946, 948; *Warner* v. *Tennessee Products Corporation* (C. C. A. 6), 57 F. (2d) 642, 643; *Cass County* v. *Rambo,* 131 S. W. (2d) 214, 216; *Safe-Deposit & Trust Co.* v. *Wright* (C. C. A. 3), 105 F. 155, 158; *Hot Springs Coal Co.* v. *Miller* (C. C. A. 10), 107 F. (2d) 677, 681; *Pittsburgh P. Glass Co.* v. *National Labor Rel. Bd.,* 313 U. S. 146, 159, 85 L. ed. 1251, 1262; *Jackson* v. *Irving Trust Co.,* 311 U. S. 494, 85 L. ed. 297, 302; *Snell* v. *J. C. Turner Lumber Co.,* 285 F. 356, 358. As the payment of a judgment in an ordinary trover action, it is deductible under the Statute, the regulations, and the decided cases. This should be particularly true where the disposition of the action actually negatived the existence of fraud or bad faith on the part of the defendant.

This was petitioner's contention before the Board of Tax Appeals and before the Circuit Court of Appeals below,

notwithstanding the Circuit Court's observation that "Petitioner's chief reliance is based on the proposition that neither of the former adjudications in the Wyoming or Delaware cases is *res judicata* of its *mala fides* or fraudulent intent because this is a different and distinct proceeding, a proceeding to assess an income tax". (See petition for rehearing, R. 410.)

We respectfully submit that the proposed application of the so-called public policy doctrine to the stipulated facts in this case, which—from the foregoing review—clearly do not involve (1) any criminal aspects, (2) actual bad faith or *mala fides*, or (3) statutory violations, involves an important new and unique question which should be considered by this Court—particularly—when the application of such doctrine in this case results in the disallowance of a deduction expressly allowed by the statute and regulations.

3. This case involves a conflict in the interpretation of the record, including this court's opinion, in the case of Mammoth Oil Co. v. U. S., 275 U. S. 13.

The Court below accepted a so-called finding of fact by the Board that Stanolind acted in bad faith and as a *mala fide* trespasser upon Government-owned lands in acquiring the oil in question. (R. 405.) This finding is bottomed upon the following conclusion of law by the Board: (R. 355, 356, 358).

> "Stanolind's good or bad faith in its transactions with Mammoth is now an issue of fact in the instant proceedings. That issue having been litigated and adjudicated in the Wyoming suit, and the record in that case having been offered and received in evidence in the instant proceedings, the judgment of the Supreme Court determining that issue is conclusive here."

This said "finding" was not, and could not be, predicated upon independent proof of record because in that respect

the record is wholly deficient.[1] This Court should, therefore, review the record because the Board's decision, and in turn that of the Circuit Court of Appeals, was based upon an erroneous conclusion of law. *Helvering* v. *Rankin,* 295 U. S. 123, 79 L. ed. 1343.

The sole issue in the Wyoming suit with respect to Stanolind was whether Stanolind had a right to use or remove its storage tanks on the lease (not whether Stanolind was entitled to compensation as an innocent improver). This is clear from the following quotation from this Court's opinion in that case: (R. 335)

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[1] This is substantiated by examination of the evidence offered at the hearing before the Board. Such proof consisted solely of (a) recitations in a stipulation of facts, signed by counsel for the Commissioner and petitioner herein, to which were attached copies of certain pleadings, orders, mandates, and decrees in the said Wyoming suit. (R. 124-137, 141-226); (b) transcripts of arguments made in the Wyoming District Court (R. 267, 270-284); (c) Stanolind's brief in the Circuit Court of Appeals in said case (R. 267, 310-318); (d) briefs filed by Stanolind and Sinclair Pipe Line Company in this Court (R. 267, 285-309); and (e)opinions in said case by the District Court, the Circuit Court of Appeals and the Supreme Court of the United States. (R. 268.)

The said stipulation of facts recited that the references therein contained to the attached pleadings, orders, mandates, decrees, etc., in the said Wyoming case should not be construed as a concession on the part of petitioner that any fact found by said courts or any of them, should be considered as a fact in this case, except and to the extent, that it was set out in the stipulation itself, or that the decisions of said courts was *res judicata* of any issue of fact or law involved in this case.

The offer in evidence of the aforementioned oral arguments in the District Court and briefs in the Circuit Court of Appeals and the Supreme Court were by agreement limited strictly to whatever bearing they might have on the identification of the issues involved in the Wyoming case, and they were received by the Board Member, subject to such limitation. (R. 266, 268.) The aforementioned opinions in the Wyoming case were specifically offered in evidence by the Commissioner "for the limited purpose of identifying the issues". (R. 268.) No independent evidence of the facts relied upon in that case was offered in this case. The so-called facts relied upon by the Board and approved by the lower Court were not adjudicated in the Wyoming case.

"The lease gave the Mammoth Company the right to construct tanks and other operating facilities on the reserve. In January, 1923, the petitioner, Sinclair Crude Oil Purchasing Company, bought from that company the tanks already constructed and others being built thereon. It used them to store Salt Creek royalty oil that it bought from the government. *It claims that it relied on the validity of the lease and became the owner of the tanks as licensee and grantee of the lessee and entitled to maintain them in all respects* as the lessee was entitled to do under the lease. It contends that the circuit court of appeals erred in directing it to be restrained from further trespassing upon the reserve, and *that in any event it should be given opportunity to remove its property.* But the Purchasing Company is presumed to have known that no law authorized the making of any such lease. The existence of that arrangement for the exhaustion of the reserve was calculated to excite the apprehensions of one considering such a purchase and put him on his guard rather than to give assurance of safety. The use of such tanks to take oil from the reserve was a part of the illegal scheme. Moreover, the Purchasing Company was owned half and half by the Sinclair Consolidated Oil Corporation and the Standard Oil Company of Indiana. Sinclair was chairman of the board of the former, and Stewart held like position in the latter. Shortly before the Purchasing Company bought the tanks, these chairmen acted for and controlled it in respect of most important transactions. That and other disclosed circumstances are sufficient to *impute* to it Sinclair's knowledge of the conspiracy to defraud by which the lease was obtained. *It is clear that, in respect of the use and removal* of these tanks, the Purchasing Company is in no better position than the Mammoth Company would have occupied, if it owned them". (Italics ours.)[1]

We submit, therefore, that the Wyoming case involved, as to Stanolind, no issues with respect to the oil in question,

[1] The Circuit Court of Appeals for the Eighth Circuit erroneously assumed that Stanolind was claiming compensation for, as well as the right to use or remove, the tanks. (R. 294, 295.) Hence, its comments are dictum and in no way controlling.

hence, it cannot be *res judicata* of any fact bearing thereon in the instant case. *Vicksburg* v. *Henson,* 231 U. S. 259, 269, 270, 273, 58 L. ed. 209, 216, 218; *Cromwell* v. *Sac County,* 94 U. S. 351, 24 L. ed. 195, 199, 200; *North Carolina R. Co.* v. *Story,* 268 U. S. 288, 293, 294, 69 L. ed. 959, 962; *Oklahoma* v. *Texas,* 272 U. S. 21, 42, 43, 71 L. ed. 145, 154; *Troxell* v. *Delaware L. & W. R. Co.,* 227 U. S. 434, 441, 442, 57 L. ed. 586, 590; *Mendez* v. *Bowie,* 118 F. (2d) 435, 441. This was admitted by counsel for the United States in both the Wyoming and Delaware suits when they alleged in the Delaware suit: (R. 243, 339).

> "* * * the cause of action in said Wyoming suit is separate and distinct from the cause of action in the above-entitled case * * *".

We believe this Court simply decided that Stanolind had failed to prove (1) that Mammoth had acquired valid title to the tanks which it gave to Stanolind, and (2) that as a purchaser for value, it was not charged, as against the true owner, with Sinclair's knowledge of the fraud by which the lease was obtained. (R. 336.)

The true legal interpretation of the Wyoming decision was stated by counsel in the Delaware case, in their report to Congress with respect to the settlement of that suit. They stated: (R. 251, 340, 341.)

> "'This suit was for the conversion of the oil by the Sinclair Crude Oil Purchasing Co. based upon the theory that *as the Mammoth Oil Co. had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.*'" (Italics ours.)

The clear implication of the foregoing quotation is that the Delaware suit was actually in no way based upon considerations of fraud or bad faith. This interpretation was adopted by the Congress. The Seventh Circuit adopted a different interpretation in the instant case. *We submit this Court should interpret its own decision and resolve this conflict.*

4. Even under the facts assumed by the lower court, the interest portion of the judgment is clearly allowable under the Commissioner's recently announced policy.

The refusal of the Board and the Court to allow as a deduction the interest portion of the judgment in question is in conflict with the Board's own decision in *Max Thomas Davis,* 46 B. T. A. 663. In that case the Board allowed as a deduction from income amounts paid as interest to the Federal Government upon compromise of civil and criminal liability resulting from willful evasion of Federal taxes. The taxpayer in that case pleaded guilty to both the civil and criminal liability. The deduction was allowed under Section 23(b) of the Revenue Act of 1936, which is identical with the Statute herein involved. The Commissioner has acquiesced in this decision. (Internal Revenue Bulletin No. 25, June 22, 1942, p. 1.)

In this case a substantial portion of the judgment, to-wit: $908,893.06, represented and was admitted by the parties to be interest. (R. 134, 249.) Under the Board decision in the *Max Thomas Davis* case, *supra,* this amount was deductible regardless of the character of the principal payment.

This point cannot be disposed of by saying that the interest in this case represents damages and not interest under the Statute, because this Court has granted a petition in *Commr.* v. *Kieselbach,* 127 F. (2d) 359 (C. C. A. 3) to determine the character of a payment made as interest on a condemnation award where the contention is made that the payment represented damages and not interest under the Statute.

The Court will be called upon to define interest, and its definition will be applicable in this case. This we submit requires the granting of the writ.

5. The lower court's decision is also in conflict in principle with other decisions.

The Court's decision is in conflict in principle with the following decisions: *U. S.* v. *Dominion Oil Co.*, 241 F. 425, 427; *U. S.* v. *Stinson*, 197 U. S. 200, 205, 49 L. ed. 724, 725; *Mountain Copper Co.* v. *U. S.*, 142 F. 625, 629; *In re Minot Auto Co.*, 298 F. 853, 857; *S. M. 4078*, (1926) C. B. V-1, p. 226; *Helvering* v. *Hampton*, (C. C. A. 9) 79 F. (2d) 358, 359, 360; *W. R. Hervey*, 25 B. T. A. 1282, 1290, 1291.

In the last two of the above-cited cases judgments in tort actions were allowed as deductions, even though fraud and bad faith were clearly involved.

The Court below seemed to recognize this general principle because it found it necessary to imply that Stanolind had also violated some criminal statute. The Court said:

> "* * * we think it tolerably safe to say that torts which are committed against the Government and which are *also violative of the criminal statutes* may not furnish the basis of deduction." (Italics ours).

Granted the correctness of the rule, it is not applicable here because Stanolind violated no criminal statute. It was not even charged with "criminal misconduct" in either the Wyoming or Delaware cases or in any other case.

6. The court below also erred in the following respects.

(a) The Circuit Court of Appeals instead of limiting its review to ascertaining whether there was evidence to support the Board's findings and decision made an independent determination based upon alleged facts and inferences drawn from without the record. This it cannot do. *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 82 L. ed. 1346. The Circuit Court is without power to make findings or determinations of fact. *Helvering* v. *Rankin, supra.*

The Court in its opinion states that it can completely eliminate from consideration the evidence which the two

judgments and pleadings and findings in the Wyoming and Delaware suits afford and still find evidence of Stanolind's guilt. The alleged facts which the Circuit Court determined from without the record are: (R. 403.)

> "* * * That Sinclair bribed the Secretary of Interior in order to obtain the Teapot Dome lease is established. The lessee thereupon turned over this lease to his wholly-owned subsidiary, the Mammoth Company. It, Mammoth, was financially irresponsible, having been organized by Sinclair, the corrupter of Secretary Fall. Its entire capital stock of a thousand dollars was issued to Sinclair for services in procuring the oil and gas lease from the United States Government. Sinclair transferred this stock in Mammoth to the Sinclair Consolidated Oil Company.
>
> "Stanolind was owned, half by Sinclair Cons. Oil Co., and half by petitioner. Thus did ownership of both companies stand when Stanolind entered into its contract with Mammoth to purchase the illegally obtained oil drawn from the Teapot Dome property. In other words, Mammoth was Sinclair. It was clearly chargeable with knowledge of Sinclair's criminal action in corruptly obtaining the Teapot Dome lease.
>
> "Sinclair also owned half of Stanolind, and Stanolind, after Sinclair had acquired half of its stock, purchased the oil obtained through the fraudulently executed lease of the Teapot Dome property. * * *"

The "bribery" element seems to be the principal one upon which the Court rests, for it asks the following question which it implies is self-answering and applicable to Stanolind: (R. 403)

> "May one who, through bribery, secures a lease from the Government, which he turns over to a company owned by himself, avoid liability arising out of his criminal misconduct and demand protection on the theory that the corporation created by him to carry out the object of his criminal enterprise, had no knowledge of the fraud or corruption?"

There is no evidence in this record which establishes the alleged bribery, even with respect to Sinclair or Mammoth, much less Stanolind. Certainly it was not established in the Wyoming case where the Supreme Court in its opinion said: (275 U. S. 53)

> "The complaint did not allege bribery, and, in the view we take of the case, there is no occasion to consider and we do not determine whether Fall was bribed in respect of the lease or agreement."

Harry Sinclair never owned any of Stanolind's stock. He was never an officer, director or employee of Stanolind. Mammoth was Harry Sinclair but Stanolind was not. Stanolind was 50 per cent petitioner and 50 per cent Sinclair Consolidated Oil Corporation, a corporation whose stock was widely dealt in on the New York Stock Exchange. Neither petitioner nor Sinclair Consolidated Oil Corporation was a party to the Wyoming litigation nor charged with being a party to the fraud.

The Court goes on to say: (R. 403)

> "Moreover, it would overtax credulity to assume, under the circumstances, that petitioner was an innocent party, unaware of what was going on at a time when Senators in the Senate and the press were charging corruption and demanding an investigation of the conditions under which the Teapot Dome lease was negotiated."

We are indeed in startling times if the Federal Courts can make such grave determinations upon the basis of assumed facts taken from the newspapers.

(b) The Court obviously confused Stanolind with Mammoth. The Court, in its opinion, says: (R. 402)

> "* * * But, uncertain and indistinct as the line may be, we have found no case which permits a taxpayer to successfully claim a deduction based on a sum which said taxpayer has paid the Government by way of dam-

ages which arose from a fraudulent transaction which the said taxpayer perpetrated upon the Government.

"And it is apparent that the case against the allowance of deductions is strengthened, if the facts warrant a finding that the taxpayer made payment to the Government, not alone because of fraud, but because of criminal corruption, to-wit, bribery."

These statements (except for the bribery part) might have applied to Mammoth if it had made the payment and then claimed the deduction. It cannot apply to Stanolind. Stanolind did not make any payment because of fraud or bribery. It paid because it had purchased oil to which the seller had no title. Against that payment it was allowed an equitable offset for its storage tanks to the extent to which the United States had been unjustly enriched. The existence of either fraud or bribery would have precluded such allowance.

(c) The Court's conclusion is based upon the declaration in the Delaware case, not the final result of that litigation. The Court says: (R. 401)

"The complaint in the suit against Stanolind charged it, jointly with Mammoth, with the fraud and corruption by which Mammoth obtained possession of the oil. On such pleading, Stanolind consented to the entry of the judgment in question."

The alleged fraud and corruption by which Mammoth obtained possession of the oil were charged only in the second and third counts of the declaration in the Delaware case. These charges could serve no possible purpose in the trover action except as they might constitute a basis for exemplary or punitive damages. These allegations are not found in the first count which sought merely the value of the oil. Stanolind consented to a judgment upon the basis of the first count only, not the second or the third count. Moreover, the final result also recognized Stanolind's equitable

right to an offset for its storage tanks on the Teapot Dome lease.[1]

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers in order that the errors herein pointed out may be corrected, and that the decree of the United States Circuit Court of Appeals for the Seventh Circuit be reversed.

Respectfully submitted,

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[1] For answer to the Court's suggestion that the allowance for the tanks may have represented a trade for 7 per cent instead of 6 per cent interest, see petition for rehearing (R. 412-414).